

**REPORT OF THE AUDIT OF THE
BREATHITT COUNTY
FISCAL COURT**

**For The Fiscal Year Ended
June 30, 2006**

**ROSS & COMPANY, PLLC
Certified Public Accountants**

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Louisville, KY
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<u>CONTENTS</u>	PAGE
INDEPENDENT AUDITOR’S REPORT.....	1
BREATHITT COUNTY OFFICIALS	3
MANAGEMENT’S DISCUSSION AND ANALYSIS.....	4
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS	12
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS.....	14
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS.....	17
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS.....	20
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS.....	23
NOTES TO FINANCIAL STATEMENTS.....	25
BUDGETARY COMPARISON SCHEDULES	39
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION	43
COMBINING BALANCE SHEET - NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS.....	45
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS	48
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	51
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS	53
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS.....	54
REPORT AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	56
REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133	59
APPENDIX A:	
CERTIFICATION OF COMPLIANCE - LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM	

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To the People of Kentucky
Honorable Ernie Fletcher, Governor
John R. Farris, Secretary
Finance and Administration Cabinet
Honorable Jason Harvey Richardson, Breathitt County Judge/Executive
Honorable Lewis Warrix, former Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Independent Auditor's Report

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County, Kentucky, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Breathitt County Fiscal Court. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for Fiscal Court Audits issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As described in Note 1, Breathitt County, Kentucky, prepares its financial statements on a prescribed basis of accounting that demonstrates compliance with the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County, Kentucky, as of June 30, 2006, and the respective changes in financial position, where applicable, thereof for the year then ended in conformity with the basis of accounting described in Note 1.

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

To the People of Kentucky
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Members of the Breathitt County Fiscal Court

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Breathitt County, Kentucky's basic financial statements. The accompanying supplementary information, combining fund financial statements, are presented for additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments and Non-Profit Organizations, and is not a required part of the basic financial statements. The combining fund financial statements and the schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation of the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued our report dated January 10, 2007, on our consideration of Breathitt County, Kentucky's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Ross & Company", written in black ink.

Ross & Company, PLLC

Audit fieldwork completed -
January 10, 2007

BREATHITT COUNTY OFFICIALS

For The Year Ended June 30, 2006

Fiscal Court Members:

Lewis H. Warrix	County Judge/Executive
James W. Combs	Commissioner
Steve Bank	Commissioner
Arch Turner	Commissioner

Other Elected Officials:

Brendon Miller	County Attorney
James E. Turner	Jailer
Tony Watts	County Clerk
Thomas E. Howard	Circuit Court Clerk
John L. Turner	Sheriff
Evine Allen	Property Valuation Administrator
Bobby G. Thorpe	Coroner

Appointed Personnel:

William K. Back	County Treasurer
Brenda Fugate	Finance Officer
Wanda K. Barnett	Occupational Tax Collector



LEWIS H. WARRIX
Breathitt County Judge Executive

1137 Main Street
Jackson, Kentucky 41339

Phone (606) 666-3800
Fax (606) 666-3813

Management's Discussion and Analysis
June 30, 2006

The financial management of Breathitt County, Kentucky offers readers of Breathitt County's financial statements this narrative overview and analysis of the financial activities of Breathitt County for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with other information that we have furnished in our letter of transmission and the notes to the financial statements.

Financial Highlights.

- Breathitt County had net assets of \$9,719,595 as of June 30, 2006. The fiscal court had unrestricted net assets of \$1,793,612 in governmental funds as of June 30, 2006. Cash and cash equivalents total assets were \$1,888,348. Total debt for governmental funds principal as of June 30, 2006 was \$8,338,565 with \$572,560 due within one year.
- The governmental activities total net assets increased by \$1,132,003 from the prior year.
- At the close of the current fiscal year, Breathitt County governmental funds reported current assets of \$2,064,342. Of this amount, \$1,586,944 is available for spending at the government's discretion (unreserved fund balance).
- Breathitt County's total indebtedness at the close of fiscal year June 30, 2006 was \$8,338,565, of which \$7,766,005 is long-term debt (due after 1 year) and \$572,560 is short-term debt (to be paid within 1 year). Debt additions were \$197,009, and debt reductions were \$868,043 for a net decrease of \$671,034 for the year.

Overview of the Financial Statements.

This management discussion and analysis is intended to serve as an introduction to Breathitt County's basic financial statements. Breathitt County's basic financial statements comprised of three components: 1) government wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

GASB 34 requires management to include certain comparison schedules when they are available. The schedules include prior and current comparisons of general revenues by major source, and program expenses by function.

Government-wide Financial Statements. The government-wide financial statements are designed to provide the readers with a broad overview of Breathitt County's finances, in a manner similar to a private-sector business.

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

The *Statement of Net Assets* presents information on all of Breathitt County's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of Breathitt County is improving or deteriorating.

The *Statement of Activities* presents information showing how the government's net assets changed during the fiscal year. All changes in net assets are reported on a modified cash basis of accounting. Basis of accounting is referred to when they result from a cash transaction, except for the recording of depreciation expenses on capital assets in the government-wide financial statements for all activities and in the fund financial statements for the proprietary fund financial statements.

As a result of the use of the modified cash basis of accounting, certain assets and their related revenues (such as amounts billed for services provided, but not collected) and accounts payable (expenses for goods and services received but not paid) or compensated absences are not recorded.

Both of the government-wide financial statements distinguish functions of the County that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or significant portion of their costs through user fees and charges (*business-type activities*). Breathitt County's governmental activities include general government, protection to persons and property, roads, recreation, social services, airport, debt service, capital projects, and administration. Breathitt County has no business type activity.

Fund Financial Statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Breathitt County, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of Breathitt County can be divided into broad categories: *governmental funds*.

Governmental Funds. Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statement. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluation a government's near-term financing requirements.

Because of focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

Breathitt County maintains (12) twelve individual governmental funds. Information is presented separately in the governmental fund budget sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances.

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

Governmental Funds (Continued).

Major Funds:

- General Fund
- Road Fund
- Local Government Economic Assistance Fund
- Community Development Block Grant Fund
- Breathitt County Kentucky Justice Center Corporation Bond Fund
- Breathitt county General Obligation Refunding Bond Series 2003 Fund

Non-Major Funds:

- Jail Fund
- Disaster and Emergency Services
- Solid Waste Fund
- E-911 Fund
- Local Government Economic Development Fund
- Economic Assistance Fund

Breathitt County adopts an annual appropriated budget. A budgetary comparison statement has been provided for the General Fund, Road Fund, Local Government Economic Assistance Fund, and Community Development Block Grant to demonstrate compliance with their budgets.

Notes to the Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Net Assets. As noted earlier, net assets may serve over time as a useful indicator of a government's financial position.

Table 1
Breathitt County's Net Assets

	Governmental Activities	
	2005	2006
Assets		
Current and other assets	2,665,464	2,064,342
Capital assets	14,932,445	15,993,818
Total assets	17,597,909	18,235,434
Liabilities		
Current and other liabilities	868,279	572,560
Long-term liabilities	8,142,038	7,766,005
Total liabilities	9,010,317	8,338,565
Net Assets		
Invested in capital assets, net of related debt	5,922,128	7,655,253
Restricted	3,256,664	270,730
Unrestricted	2,665,464	1,793,612
Total Net Assets	8,587,592	9,719,595

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

Governmental Activities. Breathitt County's net assets increased by \$1,132,003 in fiscal year 2006. Key elements of this are as follows:

- Cash decreased \$593,122, primarily due to expenditures from the Breathitt County Justice Center Corporation Bond Fund.
- Investment in capital assets and infrastructure, net of related debt increased \$1,061,373 due to the increase of construction in progress and related expenditures for infrastructure.
- Current and long-term liabilities decreased by \$671,752 due to reduction in principle.

Financial Analysis of the County's Funds.

As noted earlier, Breathitt County uses fund accounting to ensure and demonstrate compliance with finance-related requirements.

Governmental Funds Overview. The focus of Breathitt County governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the County's financing requirements. In particular, unreserved fund balances may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of June 2006 fiscal year, the combined ending fund balances of County governmental funds were \$1,888,348. Approximately 86% (\$1,586,944) of this consists of unreserved fund balance, which is available as working capital and for current spending in accordance with the purposes of the specific funds. The remainder of fund balance (\$301,404) is reserved to indicate that it is not available for new spending because it is committed for various encumbrances and capital projects.

The County has (6) six major governmental funds.

Major Funds:

- General Fund
- Road Fund
- Local Government Economic Assistance Fund
- Community Development Block Grant Fund
- Breathitt County Kentucky Justice Center Corporation Bond Fund
- Breathitt County General Obligation Refunding Bond Series 2003 Fund

Non-Major Funds

- Jail Fund
- Disaster Emergency Services
- Solid Waste Fund
- E-911 Fund
- Local Government Economic Development Fund
- Economic Assistance Fund

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

1. The General Fund is the chief operating fund of Breathitt County. At the end June 30, 2006 fiscal year, unencumbered fund balance of the General Fund was \$612,136. The County received approximately 50% of its total revenue from the 1% occupational tax. A total of \$45,041 was received in real and personal property, motor vehicle, and other taxes for approximately 23% of the county's general revenues. Various other service fees and miscellaneous revenues contribute to the remaining 27% of revenues. The fiscal year expenditures for the General Fund were \$1,574,585.
2. The Road Fund is the fund related to the County road, bridge construction and maintenance. The Road Fund had an unencumbered cash balance of \$152,853 at June 30, 2006. The General Fund contributed \$200,000 to the Road Fund for the paving of roads. The fiscal year 2006 expenditures for Road Fund were \$2,273,296 and include the transfer of funds to general obligation bonds for payment of department services.
3. The Jail Fund is used to account for the operation of the County's detention program. The Jail Fund had a balance at end June 30, 2006 of \$14,327. The Jail Fund received \$124,228 for intergovernmental fees, primarily for housing prisoners. The General Fund contributed \$190,000 and the L.G.E.A. Fund contributed \$152,000 to the jail operations.
4. The L.G.E.A. Fund had a balance of \$146,321 as of June 30, 2006, for funding of the Coroner's Office and Animal Control. The L.G.E.A. Fund contributed \$250,000 to the Community Economic Growth & Assistance Fund and \$150,000 to the Jail Fund. For the fiscal year total expenditures were \$240,525.
5. The Community Development Block Grant Fund established for the KY541 Water Lines had a balance of zero. This fund was established to account for the pass through funds in the amount of \$516,585 from various agencies for construction of KY541 Water Lines.
6. The D.E.S. Fund had a balance of \$40,671. Breathitt County was designated the Regional Center and received Weapons of Mass Destruction funding in the amount of \$65,422.
7. The Solid Waste Fund had a June 30, 2006 balance of \$142,695. This fund accounts for the receipt and disbursement of garbage collection service contracted by the fiscal court.
8. The E-911 Fund accounts for the operation of the City/County emergency operations communications. The fund had a balance of \$110,279 at the end of the June 30, 2006 fiscal year. Tax revenue from telephone and cell phones for the fiscal year was \$101,653.
9. The L.G.E.D. Fund had a balance of \$12,033. This fund accounts for the receipt and disbursement of coal severance line item projects.
10. The Economic Assistance Fund was established for conversion of the Breathitt County Jail to a Welcome Center/Museum. This project is funded by \$150,000 in coal severance funds and an Inter Fund Transfer of \$250,000 from the Local Economic Assistance Fund for a total of \$400,000 in revenue. This project was in the planning stage and \$13,697 funds were expended from this account during the fiscal year.

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

General Fund Budgetary Highlights.

Breathitt County's budget was amended during the fiscal year increasing the budgeted amount by \$781,114. Budget Amendments were made to various expenditures due to grants awarded in the fiscal year, surplus cash carried forward, and an increase in actual tax revenue.

Capital Assets and Debt Administration.

Capital Assets. Breathitt County's investment in capital assets for its governmental activities as of June 30, 2006, amount to \$15,993,818 (net or accumulated depreciation). This investment in capital assets includes land, buildings improvements to land other than buildings, machinery and equipment, vehicles, current infrastructure additions. Breathitt County is reporting infrastructure assets per GASB 34 provisions.

Major capital asset events during the 2006 fiscal year included continued construction of the Judicial Center, construction of infrastructure and the purchase of road equipment.

Additional information on the County's capital assets can be found in Note 3 of this report.

Table 2
Breathitt County's Capital Assets, Net of Accumulated Depreciation

	Governmental Activities	
	2005	2006
Land	1,727,786	1,727,786
Construction in Progress	6,271,968	6,959,309
Bldgs. & Improvements	5,820,814	5,770,859
Vehicles & Equipment	691,269	822,915
Infrastructure	420,608	712,949
Total Net Capital Assets	14,932,445	15,993,818

Long-term Debt. At the end of the 2006 fiscal year, Breathitt County had total bonded debt outstanding of \$7,735,000. The totals include General Obligation Bonds of \$290,000, and Revenue Bonds of \$7,445,000. Breathitt County had other Financing Obligations of \$603,565 to include capital leases and a loan guaranty. Additional information on the County's debt can be found in Note 4 of this report.

Breathitt County
Management's Discussion and Analysis
June 30, 2006
(Continued)

Other Matters. The following factors are expected to have a significant effect on the County's financial position or results of operations and were taken into account in developing the 2007 fiscal year budget:

- The 2007 fiscal year adopted budget continues most services at current levels.
- Program cuts as the State level, particularly relating to the cost of housing prisoners, may have a negative impact on funding for county programs.
Jail population continues to increase along with the cost to transport and house prisoners at regional jail facilities outside the county.
- Economic factors indicate a flat rate of growth for the county.
- Employee benefits, including health care insurance and retirement, continue to increase.
- Fuel costs are reaching historic levels.

Requests For Information.

This financial report is designed to provide a general overview of Breathitt County's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this or requests for additional financial information should be addressed to the Breathitt County Treasurer, 1137 Main Street, Jackson, Kentucky 41339.

BREATHITT COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2006

BREATHITT COUNTY
STATEMENT OF NET ASSETS - MODIFIED CASH BASIS

June 30, 2006

	Primary Government Governmental Activities
ASSETS	
Current Assets:	
Cash and Cash Equivalents	\$ 1,888,348
Capital Assets Held for Resale	175,994
Total Current Assets	<u>2,064,342</u>
Noncurrent Assets:	
Capital Assets - Net of Accumulated Depreciation	
Land	1,727,786
Construction in Process	6,959,309
Buildings	5,770,859
Vehicles and Equipment	822,915
Infrastructure Assets - Net of Depreciation	712,949
Total Noncurrent Assets	<u>15,993,818</u>
Total Assets	<u>18,058,160</u>
LIABILITIES	
Current Liabilities:	
Bonds Payable	330,000
Financing Obligations Payable	242,560
Total Current Liabilities	<u>572,560</u>
Noncurrent Liabilities:	
Bonds Payable	7,405,000
Financing Obligations Payable	361,005
Total Noncurrent Liabilities	<u>7,766,005</u>
Total Liabilities	<u>8,338,565</u>
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	7,655,253
Restricted For:	
Capital Projects	269,440
Debt Service	1,290
Unrestricted	1,793,612
Total Net Assets	<u>\$ 9,719,595</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2006

BREATHITT COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

		Program Revenues Received		
Functions/Programs Reporting Entity	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government:				
Governmental Activities:				
General Government	\$ 1,781,596		\$ 867,717	\$ 150,000
Protection to Persons and Property	787,475		189,649	
General Health and Sanitation	701,293	83,802	561,694	
Social Services	27,289			
Recreation and Culture	49,105		251,000	
Roads	1,579,758		2,284,294	
Debt Service (Interest)	342,303			
Total Governmental Activities	5,268,819	83,802	4,154,354	150,000
Total Primary Government	\$ 5,268,819	\$ 83,802	\$ 4,154,354	\$ 150,000

General Revenues:

Taxes:

Real Property Taxes

Personal Property Taxes

Motor Vehicle Taxes

Telephone Taxes (E-911)

Other Taxes

Excess Fees

Licenses and Permits

Miscellaneous Revenues

Accrued Interest Received

Total General Revenues

Change in Net Assets

Net Assets - Beginning (Restated)

Net Assets - Ending

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS
For The Year Ended June 30, 2006
(Continued)

Net (Expenses) Revenues and Changes in Net Assets	
Primary Government	
Governmental Activities	
\$	(763,879)
	(597,826)
	(55,797)
	(27,289)
	201,895
	704,536
	(342,303)
	(880,663)
\$	(880,663)
	276,679
	16,596
	71,699
	101,653
	1,082,295
	59,462
	19,034
	355,866
	29,717
	2,013,001
	1,132,338
	8,587,257
\$	9,719,595

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2006

BREATHITT COUNTY
BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

June 30, 2006

	General Fund	Road Fund	Local Government Economic Assistance Fund	Justice Center Corporation Bond Fund	General Obligation Refunding Bond Series 2003 Fund
ASSETS					
Cash and Cash Equivalents	\$ 612,136	\$ 152,853	\$ 146,321	\$ 269,440	\$ 1,290
Total Assets	<u>\$ 612,136</u>	<u>\$ 152,853</u>	<u>\$ 146,321</u>	<u>\$ 269,440</u>	<u>\$ 1,290</u>
FUND BALANCES					
Fund Balances:					
Reserved for:					
Encumbrances	\$ 0	\$ 698	\$ 0	\$ 0	\$ 0
Debt Service					1,290
Capital Projects Funds				269,440	
Unreserved:					
General Fund	612,136				
Special Revenue Funds		152,155	146,321		
Total Fund Balances	<u>\$ 612,136</u>	<u>\$ 152,853</u>	<u>\$ 146,321</u>	<u>\$ 269,440</u>	<u>\$ 1,290</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY**BALANCE SHEET - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS****June 30, 2006****(Continued)**

Non- Major Funds	Total Governmental Funds
\$ 706,308	\$ 1,888,348
<u>\$ 706,308</u>	<u>\$ 1,888,348</u>

\$ 29,976	\$ 30,674
	1,290
	269,440
	612,136
<u>676,332</u>	<u>974,808</u>
<u>\$ 706,308</u>	<u>\$ 1,888,348</u>

**Reconciliation of the Balance Sheet - Governmental
Funds to the Statement of Net Assets**

Total Fund Balances	\$ 1,888,348
Amounts Reported For Governmental Activities In The Statement Of Net Assets Are Different Because:	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	17,582,088
Accumulated Depreciation	(1,588,270)
Capital Assets Held For Resale	175,994
Long-term debt is not due and payable in the current period and, therefore, is not reported in the funds.	
Financing obligations	(603,565)
Bonded debt	<u>(7,735,000)</u>
Net Assets Of Governmental Activities	<u>\$ 9,719,595</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

BREATHITT COUNTY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

	General Fund	Road Fund	Local Government Economic Assistance Fund	Community Development Block Grant Fund	Justice Center Corporation Bond Fund
REVENUES					
Taxes	\$ 1,447,269	\$	\$	\$	\$
Excess Fees	59,462				
Licenses and Permits	19,033				
Intergovernmental	296,850	1,681,160	603,134	516,585	570,866
Charges for Services					
Miscellaneous	175,932	88,355	78,416		
Interest	6,487	4,573	2,398		6,737
Total Revenues	<u>2,005,033</u>	<u>1,774,088</u>	<u>683,948</u>	<u>516,585</u>	<u>577,603</u>
EXPENDITURES					
General Government	1,077,600		50,035		
Protection to Persons and Property	56,844				
General Health and Sanitation			57,233	516,585	
Social Services	27,289				
Recreation and Culture			8,105		
Roads		1,927,924	88,719		
Debt Service:					
Principal		35,451	2,592		295,000
Interest	7,181	11,551	2,908		274,655
Capital Projects					687,341
Administration	405,671	185,720	30,933		3,750
Total Expenditures	<u>1,574,585</u>	<u>2,160,646</u>	<u>240,525</u>	<u>516,585</u>	<u>1,260,746</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>430,448</u>	<u>(386,558)</u>	<u>443,423</u>		<u>(683,143)</u>
Other Financing Sources (Uses)					
Capital Lease Proceeds		175,994			
Transfers From Other Funds		200,000			
Transfers To Other Funds	(390,000)	(112,650)	(402,000)		
Total Other Financing Sources (Uses)	<u>(390,000)</u>	<u>263,344</u>	<u>(402,000)</u>		
Net Change in Fund Balances	40,448	(123,214)	41,423		(683,143)
Fund Balances - Beginning (Restated)	571,688	276,067	104,898		952,583
Fund Balances - Ending	<u>\$ 612,136</u>	<u>\$ 152,853</u>	<u>\$ 146,321</u>	<u>\$</u>	<u>\$ 269,440</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
For The Year Ended June 30, 2006
(Continued)

General Obligation Refunding Bond Series 2003 Fund	Non- Major Funds	Total Governmental Funds
\$	\$ 101,653	\$ 1,548,922
		59,462
		19,033
	635,759	4,304,354
	83,802	83,802
	13,164	355,867
6,954	2,568	29,717
<u>6,954</u>	<u>836,946</u>	<u>6,401,157</u>
	214,179	1,341,814
	650,724	707,568
	86,294	660,112
		27,289
	41,000	49,105
		2,016,643
535,000		868,043
45,243	765	342,303
		687,341
	52,408	678,482
<u>580,243</u>	<u>1,045,370</u>	<u>7,378,700</u>
<u>(573,289)</u>	<u>(208,424)</u>	<u>(977,543)</u>
	21,015	197,009
140,649	592,000	932,649
	(27,999)	(932,649)
<u>140,649</u>	<u>585,016</u>	<u>197,009</u>
(432,640)	376,592	(780,534)
433,930	329,716	2,668,882
<u>\$ 1,290</u>	<u>\$ 706,308</u>	<u>\$ 1,888,348</u>

The accompanying notes are an integral part of the financial statements.

BREATHITT COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

BREATHITT COUNTY
RECONCILIATION OF THE STATEMENT OF REVENUES,
EXPENDITURES, AND CHANGES IN FUND BALANCES OF
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES - MODIFIED CASH BASIS

For The Year Ended June 30, 2006

Reconciliation to the Statement of Activities:

Net Change in Fund Balances - Total Governmental Funds	\$ (780,534)
Capital lease proceeds not reflected in the government-wide financial statements as revenue	(197,009)
Governmental Funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.	
Capital Outlay	1,280,238
Assets Held For Resale	175,994
Depreciation Expense	(189,994)
Disposal of Capital Assets, Net Book Value	(24,400)
Bond and financing obligation principal payments are expensed in the Governmental Funds as a use of current financial resources. These transactions, however, have no effect on net assets.	
Financing Obligations Principal Payments	38,043
Bond Principal Payments	<u>830,000</u>
Change in Net Assets of Governmental Activities	<u>\$ 1,132,338</u>

The accompanying notes are an integral part of the financial statements.

**INDEX FOR NOTES
TO THE FINANCIAL STATEMENTS**

NOTE 1.	SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES.....	25
NOTE 2.	DEPOSITS	30
NOTE 3.	CAPITAL ASSETS.....	31
NOTE 4.	LONG-TERM DEBT	31
NOTE 5.	INTEREST ON LONG-TERM DEBT.....	36
NOTE 6.	EMPLOYEE RETIREMENT SYSTEM	37
NOTE 7.	INSURANCE	37
NOTE 8.	PRIOR PERIOD ADJUSTMENTS.....	37

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS

June 30, 2006

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

The county presents its government-wide and fund financial statements in accordance with a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this basis of accounting, assets, liabilities, and related revenues and expenditures are recorded when they result from cash transactions, with a few exceptions. This modified cash basis recognizes revenues when received and expenditures when paid. Property tax receivables, accounts payable, compensated absences, and donated assets, among other items, are not reflected in the financial statements.

Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance (Reserved for Encumbrances).

The State Local Finance Officer does not require the county to report capital assets and infrastructure; however the value of these assets is included in the Statement of Net Assets and the corresponding depreciation expense is included on the Statement of Activities.

B. Reporting Entity

The financial statements of Breathitt County include the funds, agencies, boards, and entities for which the fiscal court is financially accountable. Financial accountability, as defined by Section 2100 of the Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards, as amended by GASB 14 and GASB 39, was determined on the basis of the government's ability to significantly influence operations, select the governing authority, participate in fiscal management and the scope of public service. Consequently, the reporting entity includes organizations that are legally separate from the primary government. Legally separate organizations are reported as component units if either the county is financially accountable or the organization's exclusion would cause the county's financial statements to be misleading or incomplete. Component units may be blended or discretely presented. Blended component units either provide their services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as the primary government. All other component units are discretely presented. Breathitt County does not have any discretely presented component units.

Blended Component Units

The following legally separate organizations provide their services exclusively to the primary government, and the fiscal court is able to impose its will on this organization. These organizations' balances and transactions are reported as though they are part of the county's primary government using the blending method.

Breathitt County Public Properties Corporation:

The Breathitt County Fiscal Court appoints a voting majority of the Breathitt County Public Properties Corporation's governing board and has the ability to impose its will on the governing board. In addition, the fiscal court is financially accountable and legally obligated for the debt of the Breathitt County Public Properties Corporation.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

C. Breathitt County Elected Officials

Kentucky law provides for election of the officials below from the geographic area constituting Breathitt County. Pursuant to state statute, these officials perform various services for the Commonwealth of Kentucky, its judicial courts, the fiscal court, various cities and special districts within the county, and the board of education. In exercising these responsibilities, however, they are required to comply with state laws. Audits of their financial statements are issued separately and individually and can be obtained from their respective administrative offices. These financial statements are not included in the financial statements of Breathitt County, Kentucky.

- Circuit Court Clerk
- County Attorney
- Property Valuation Administrator
- County Clerk
- County Sheriff

D. Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government and its non-fiduciary component units. For the most part, the effect of interfund activities has been removed from these statements. Governmental activities are supported by taxes and intergovernmental revenues. Business-type revenues come mostly from fees charged to external parties for goods or services. Fiduciary funds are not included in these financial statements due to the unavailability of fiduciary funds to aid in the support of government programs.

The statement of net assets presents the reporting entity's non-fiduciary assets and liabilities, the difference between the two being reported as net assets. Net assets are reported in three categories: 1) invested in capital assets, net of related debt - consisting of capital assets, net of accumulated depreciation and reduced by outstanding balances for debt related to the acquisition, construction, or improvement of those assets; 2) restricted net assets - resulting from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation; and 3) unrestricted net assets - those assets that do not meet the definition of restricted net assets or invested in capital assets.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include: 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function; 2) operating grants and contributions; and 3) capital grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Internally dedicated resources such as taxes and unrestricted state funds are reported as general revenues.

Funds are characterized as either major or non-major. Since there is only one fund type (governmental) presented for Breathitt County, major funds are those whose total assets, liabilities, revenues, or expenditures/expenses are a least ten percent of the corresponding total for all governmental funds combined. The fiscal court may also designate any fund as major. Major individual governmental funds are reported as separate columns in the financial statements.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

Governmental Funds

The primary government reports the following major governmental funds:

General Fund - This is the primary operating fund of the fiscal court. It accounts for all financial resources of the general government, except where the Governor's Office for Local Development requires a separate fund or where management requires that a separate fund be used for some function.

Road Fund - This fund is for road and bridge construction and repair. The primary source of revenue for this fund is state payments for truck licenses distribution, municipal road aid, and transportation grants. The Governor's Office for Local Development requires the fiscal court to maintain these receipts and expenditures separately from the General Fund.

Local Government Economic Assistance Fund – These funds may be spent for public safety, environmental protection, public transportation, health, recreation, libraries, social services, industrial and economic development, workforce training, and secondary wood industry development. In no event shall these funds be used for expenses relating to the administration of government. The Governor's Office of Local Development requires the Fiscal Court to maintain these revenues and expenditures separately from the General Fund.

Community Development Block Grant Fund – This fund is used to account for the receipts and disbursements of federal and state block grants.

Justice Center Corporation Bond Fund – The Justice Center Corporation accounts for the activities of the Breathitt County Justice Center Corporation, a blended component unit of the county. The Breathitt County Justice Center Corporation issued debt to build facilities and additions to the justice center. The Breathitt County Justice Center Corporation entered into a contract, lease and option with the County and Administrative Office of the Courts (AOC), Commonwealth of Kentucky. The Governor's Office for Local Development does not require the fiscal court to report or budget these funds.

General Obligation Refunding Bond Series 2003 Fund - The primary purpose of this fund is to account for debt service requirement of the General Obligation Series 2003 Bond issue. The Governor's Office for Local Development does not require the fiscal court to report or budget these funds.

The primary government also has the following non-major funds: Jail Fund, Disaster and Emergency Service Fund, Solid Waste Fund, E-911 Fund, Local Government Economic Development Fund, and Economic Assistance Fund.

Special Revenue Funds:

The Road Fund, Jail Fund, Local Government Economic Assistance Fund, Community Development Block Grant Fund, Disaster and Emergency Service Fund, Solid Waste Fund, E-911 Fund, Local Government Economic Development Fund, and Economic Assistance Fund are presented as special revenue funds. Special revenue funds are to account for the proceeds of specific revenue sources and expenditures that are legally restricted for specific purposes.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

D. Government-wide and Fund Financial Statements (Continued)

Governmental Funds (Continued)

Capital Projects Fund:

The Justice Center Corporation Bond Fund is presented as a capital projects fund. Capital projects funds are to account for the financial resources to be used for the acquisition or construction of major capital facilities.

Debt Service Fund:

The General Obligation Refunding Bond Series 2003 Fund is presented as a debt service fund. Debt service funds are to account for the accumulation of resources for, and the payment of general long-term principal and interest.

Generally and except as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) November 1, due at discount November 30, due at face value December 31, delinquent January 31 following the assessment, and subject to lien and sale on June 30 following the delinquency date.

E. Deposits and Investments

The government's cash and cash equivalents are considered to be cash on hand, demand deposits, certificates of deposit, and short-term investments with original maturities of three months or less from the date of acquisition.

KRS 66.480 authorizes the county to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

F. Capital Assets

Capital assets, which include land, land improvements, buildings, furniture and office equipment, building improvements, machinery, equipment, and infrastructure assets (roads and bridges) that have a useful life of more than one reporting period based on the government's capitalization policy, are reported in the applicable governmental or business-type activities of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost when purchased or constructed.

Cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's life are not capitalized. Land and Construction In Progress are not depreciated. Interest incurred during construction is not capitalized. Capital assets and infrastructure are depreciated using the straight-line method of depreciation over the estimated useful life of the asset. The county is reporting only infrastructure placed in service after July 1, 2003.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

F. Capital Assets (Continued)

	Capitalization Threshold	Useful Life (Years)
Land Improvements	\$ 12,500	10-60
Buildings and Building Improvements	25,000	10-75
Machinery and Equipment	2,500	3-25
Vehicles	2,500	3-5
Infrastructure	20,000	10-50

G. Long-term Obligations

In the government-wide financial statements long-term debt and other long-term obligations are reported as liabilities in the applicable financial statements. The principal amount of bonds, notes and financing obligations are reported.

In the fund financial statements, governmental fund types recognize bond interest, as well as bond issuance costs when received or when paid, during the current period. The principal amount of the debt and interest are reported as expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as expenditures. Debt proceeds are reported as other financing sources.

H. Fund Equity

In the fund financial statements, the difference between the assets and liabilities of governmental funds is reported as fund balance. Fund balance is divided into reserved and unreserved components, with unreserved considered available for new spending. Unreserved fund balances, may be divided into designated and undesignated portions. Designations represent fiscal court's intended use of the resources and should reflect actual plans approved by the fiscal court.

Governmental funds report reservations of fund balance for amounts that are legally restricted by outside parties for use for a specific purpose, and encumbrances. "Reserved for Encumbrances" are purchase orders that will be fulfilled in a subsequent fiscal period. Although the purchase order or contract creates a legal commitment, the fiscal court incurs no liability until performance has occurred on the part of the party with whom the fiscal court has entered into the arrangement. When a government intends to honor outstanding commitments in subsequent periods, such amounts are encumbered. Encumbrances lapse at year-end and are not reflected on the Statement of Net Assets and Statement of Activities; however, encumbrances are reflected on the Balance Sheet - Governmental Funds as part of the fund balance.

I. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 1. Summary of Significant Accounting Policies (Continued)

I. Budgetary Information (Continued)

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

A formal budget is not adopted for the Breathitt County Public Properties Corporation Justice Center Fund. The Governor's Office for Local Development does not require this fund to be budgeted.

Note 2. Deposits

The primary government and component unit maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the county and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution. These requirements were met.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the County's deposits may not be returned. The County does not have a deposit policy for custodial credit risk, but rather follows the requirements of KRS 41.240(4). As of February 28, 2006 and June 30, 2006, the County's deposits of \$2,664,478 and \$1,791,722 were exposed to custodial credit risk as follows:

- Unsecured and uncollateralized - \$1,464,478 as of February 28, 2006
- Unsecured and uncollateralized - \$591,722 as of June 30, 2006

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 3. Capital Assets

Capital asset activity for the year ended June 30, 2006 was as follows:

	Reporting Entity			
	Beginning Balance	Increases	Decreases	Ending Balance
Primary Government:				
<u>Governmental Activities:</u>				
Capital Assets Not Being Depreciated:				
Land	\$ 1,727,786	\$	\$	\$ 1,727,786
Construction In Progress	6,271,968	687,371		6,959,339
Total Capital Assets Not Being Depreciated	7,999,754	687,371		8,687,125
Capital Assets, Being Depreciated:				
Buildings	6,825,500			6,825,500
Vehicles and Equipment	1,140,655	240,797	(122,000)	1,259,452
Infrastructure	457,941	352,070		810,011
Total Capital Assets Being Depreciated	8,424,096	592,867	(122,000)	8,894,963
Less Accumulated Depreciation For:				
Buildings	(1,004,686)	(49,955)		(1,054,641)
Vehicles and Equipment	(449,386)	(84,751)	97,600	(436,537)
Infrastructure	(41,804)	(55,258)		(97,062)
Total Accumulated Depreciation	(1,495,876)	(189,964)	97,600	(1,588,240)
Total Capital Assets, Being Depreciated, Net	6,928,220	402,903	(24,400)	7,306,723
Governmental Activities Capital Assets, Net	\$ 14,927,974	\$ 1,090,274	\$ (24,400)	\$ 15,993,848

Depreciation expense was charged to functions of the primary government as follows:

<u>Governmental Activities:</u>	
General Government	\$ 30,361
Protection to Persons and Property	44,830
General Health and Sanitation	23,850
Roads	90,923
Total Depreciation Expense - Governmental Activities	\$ 189,964

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Long-term Debt

A. First Mortgage Revenue Bonds (Justice Center Project), Series 2003

On April 1, 2003, the Breathitt County, Kentucky Justice Center Corporation, a component unit of the Breathitt County Fiscal Court, issued \$8,030,000 in First Mortgage Revenue Bonds for the construction of the Justice Center. Semiannual principal and interest payments are required in April and October of each year beginning October 2003. The bonds will be paid in full October 2023.

The Breathitt County, Kentucky Justice Center Corporation is acting as an agent for the Administrative Office of the Courts (AOC) in order to manage and maintain the Breathitt County Justice Center. The Breathitt County Kentucky, Justice Center Corporation expects rentals for use of the Breathitt County Justice Center to be in the full amount of the principal and interest requirements of the bonds.

Under the terms of a lease, the AOC has agreed to pay directly to the paying agent bank, the use allowance payment as provided in the lease. The lease agreement is renewable each year. The Breathitt County, Kentucky Justice Center Corporation is in reliance upon the use allowance payment in order to meet debt service on the bonds.

The AOC with the execution of the lease expressed its intention to continue to pay the full allowance payment. However, the lease does not obligate the AOC to do so.

As of June 30, 2006, the principal balance on these bonds was \$7,445,000. Debt service requirements for the remaining years are:

	<u>Governmental Activities</u>	
<u>Fiscal Year Ended</u> <u>June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	305,000	265,695
2008	315,000	256,355
2009	325,000	246,755
2010	335,000	236,855
2011	345,000	226,224
2012-2016	1,910,000	944,477
2017-2021	2,295,000	557,543
2022-2023	<u>1,615,000</u>	<u>98,700</u>
Totals	<u>\$ 7,445,000</u>	<u>\$ 2,832,604</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Long-Term Debt (Continued)

B. General Obligation Refunding Bond, Series 2003

On July 1, 2003, the County issued \$865,000 in General Obligation Refunding Bonds, Series 2003. The proceeds from these refunding bonds were used to refinance the Breathitt County Public Properties Corporation Series 1994 Road bonds, the Breathitt County Public Properties Corporation Series 1996 Jail bonds, and a 1998 capital lease for a grader. These bonds are scheduled to mature in February 2016; interest payments are due every six months starting in February 2004 and principal payments are due annually beginning in February 2004. At June 30, 2006, the principal balance outstanding on these bonds was \$290,000. Debt service requirements for fiscal years ending June 30, 2007, and thereafter are as follows:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2007	25,000	9,939
2008	25,000	9,139
2009	25,000	8,339
2010	30,000	7,539
2011	30,000	6,579
2012-2016	155,000	15,951
Totals	<u>\$ 290,000</u>	<u>\$ 57,486</u>

C. Grader and Dump Trucks

On December 4, 2003, the County entered into a lease agreement with Kentucky Association of Counties for the purchase of a grader and three dump trucks. Terms of the lease agreement stipulate an 8-year repayment schedule with monthly interest payments and annual principal payments. As of June 30, 2006, the principal balance outstanding was \$185,304. Debt service requirements for fiscal years ending June 30, 2007, and thereafter are as follows:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2007	29,005	8,739
2008	30,461	7,263
2009	31,989	5,706
2010	33,595	4,072
2011	35,280	2,354
2012	24,974	772
Totals	<u>\$ 185,304</u>	<u>\$ 28,906</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Long-Term Debt (Continued)

D. Tractor/Mower

On July 15, 2003, the County entered into a lease agreement with First National Bank for the purchase of a tractor/mower. Terms of the lease agreement stipulate a four-year repayment schedule with monthly principal and interest payments of \$764. As of June 30, 2006, the principal balance outstanding was \$9,607. Debt service requirements for fiscal years ending June 30, 2007, and thereafter are as follows:

	<u>Governmental Activities</u>	
<u>Fiscal Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 8,919	250
2008	<u>688</u>	<u>3</u>
Totals	<u>\$ 9,607</u>	<u>\$ 253</u>

E. Loan Guaranty - Airport

On November 1, 1999, the County and the City of Jackson entered into an unsecured guaranty agreement with First National Bank. The agreement stipulates the County and City of Jackson will guarantee payments on a loan that was entered into by the Jackson/Breathitt Airport Board in the amount of \$156,317. Terms of the agreement stipulate a principal and interest payment of \$1,000 per month with a termination date of November 16, 2019. The County and the City of Jackson currently pay an equal payment of \$500 each directly to the First National Bank. As of June 30, 2006, the County's portion of the principal balance outstanding was \$61,645. Debt service requirement for the County's portion for fiscal years ending June 30, 2007, and thereafter are as follows:

	<u>Governmental Activities</u>	
<u>Fiscal Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>
2007	\$ 2,972	3,028
2008	3,116	2,884
2009	3,284	2,716
2010	3,452	2,548
2011	3,628	2,372
2012-2016	21,112	8,888
2017-2021	<u>24,081</u>	<u>12,882</u>
Totals	<u>\$ 61,645</u>	<u>\$ 35,318</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Long-Term Debt (Continued)

F. Redesign of the Breathitt County Detention Center

On January 31, 2005, the County entered into a lease agreement with Kentucky Association of Counties Leasing Trust for the redesign of the Breathitt County Detention Center. Terms of the lease agreement stipulate a 7-year repayment schedule with monthly principal and interest payments. Principal payments are to commence on July 20, 2006. As of June 30, 2006, the principal balance outstanding was \$150,000. Debt service requirements for fiscal years ending June 30, 2007, and thereafter are as follows:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2007	\$ 20,670	\$ 7,084
2008	21,286	6,043
2009	21,921	4,960
2010	22,575	3,847
2011	23,249	2,700
2012-2013	40,299	1,865
Totals	<u>\$ 150,000</u>	<u>\$ 26,499</u>

G. Van

On November 22, 2005, the County entered into a lease agreement with Kentucky Association of Counties Leasing Trust for the purchase of a van for use by the county. Terms of the lease agreement stipulate a 4-year repayment schedule with an annual principal payment and monthly interest payments. Principal payments are to commence on July 20, 2006. As of June 30, 2006, the principal balance outstanding was \$21,015. Debt service requirements for fiscal years ending June 30, 2007, and thereafter are as follows:

Fiscal Year Ended June 30	Governmental Activities	
	Principal	Interest
2007	\$ 5,000	\$ 755
2008	5,000	670
2009	5,000	508
2010	6,015	41
Total	<u>\$ 21,015</u>	<u>\$ 1,974</u>

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 4. Long-term Debt (Continued)

H. Trucks

On June 30, 2006 the county entered into a lease agreement with Kentucky Association of Counties Leasing Trust for the purchase of two new Mack trucks. The terms of the lease agreement stipulate a one-year repayment with monthly interest payments beginning July 2006 and a lump sum principal payment in June 2007. The county purchased the truck to use for one year; then the trucks will be sold at auction. As of June 30, 2006 the principal outstanding was 175,994. Debt service requirements for fiscal year ending June 30, 2007 are as follows:

	<u>Governmental Activities</u>	
Fiscal Year Ended June 30	<u>Principal</u>	<u>Interest</u>
2007	<u>\$ 175,994</u>	<u>\$ 8,512</u>

I. Changes In Long-term Liabilities

Long-term liability activity for the year ended June 30, 2006, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Primary Government:					
<u>Governmental Activities:</u>					
Revenue Bonds	\$ 8,130,000		\$ 685,000	\$ 7,445,000	\$ 305,000
General Obligation Refunding Bonds	435,000		145,000	290,000	25,000
Financing Obligations (Restated)	<u>444,599</u>	<u>197,009</u>	<u>38,043</u>	<u>603,565</u>	<u>242,560</u>
Governmental Activities					
Long-term Liabilities	<u>\$ 9,009,599</u>	<u>\$ 197,009</u>	<u>\$ 868,043</u>	<u>\$ 8,338,565</u>	<u>\$ 572,560</u>

Note 5. Interest On Long-Term Debt And Financing Obligations

Debt Service on the Statement of Activities includes \$22,405 in interest on financing obligations and \$319,898 in interest on bonds.

BREATHITT COUNTY
NOTES TO FINANCIAL STATEMENTS
June 30, 2006
(Continued)

Note 6. Employee Retirement System

The county has elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost sharing multiple-employer defined benefit pension plan, which covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members. Benefit contributions and provisions are established by statute. Nonhazardous duty covered employees are required to contribute 5 percent of their salary to the plan. The county's contribution rate for nonhazardous duty employees was 10.98 percent.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65.

Historical trend information showing the CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report. This report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Ky 40601-6124, or by telephone at (502) 564-4646.

Note 7. Insurance

For the fiscal year ended June 30, 2006, Breathitt County was a member of the Kentucky Association of Counties' All Lines Fund (KALF). KALF is a self-insurance fund and was organized to obtain lower cost coverage for general liability, property damage, public officials' errors and omissions, public liability, and other damages. The basic nature of a self-insurance program is that of a collectively shared risk by its members. If losses incurred for covered claims exceed the resources contributed by the members, the members are responsible for payment of the excess losses.

Note 8. Prior Period Adjustments

The prior year fund balances for the General Fund, Road Fund, Local Governmental Economic Assistance Fund and E-911 Fund have been restated by \$323, \$241, \$39, and \$2,815, respectively due to prior year voided checks. Prior year net assets were restated by \$335 due to an error in computing prior year depreciation. In addition, beginning liabilities were restated by \$718.

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis

For The Year Ended June 30, 2006

	GENERAL FUND			
	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Taxes	\$ 1,216,000	\$ 1,503,954	\$ 1,447,269	\$ (56,685)
Excess Fees		59,462	59,462	
Licenses and Permits		14,959	19,033	4,074
Intergovernmental Revenue	37,100	312,964	296,850	(16,114)
Miscellaneous	109,000	176,125	175,932	(193)
Interest	1,500	5,885	6,487	602
Total Revenues	<u>1,363,600</u>	<u>2,073,349</u>	<u>2,005,033</u>	<u>(68,316)</u>
EXPENDITURES				
General Government	985,518	1,365,523	1,077,600	287,923
Protection to Persons and Property	58,318	75,973	56,844	19,129
Social Services	26,500	29,150	27,289	1,861
Debt Service:				
Interest	7,558	7,558	7,181	377
Administration	478,783	859,587	405,671	453,916
Total Expenditures	<u>1,556,677</u>	<u>2,337,791</u>	<u>1,574,585</u>	<u>763,206</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>(193,077)</u>	<u>(264,442)</u>	<u>430,448</u>	<u>694,890</u>
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	100,000	100,000		(100,000)
Transfers To Other Funds	(406,923)	(506,923)	(390,000)	116,923
Total Other Financing Sources (Uses)	<u>(306,923)</u>	<u>(406,923)</u>	<u>(390,000)</u>	<u>16,923</u>
Net Changes in Fund Balance	(500,000)	(671,365)	40,448	711,813
Fund Balance - Beginning (Restated)	<u>500,000</u>	<u>571,365</u>	<u>571,688</u>	<u>323</u>
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ (100,000)</u>	<u>\$ 612,136</u>	<u>\$ 712,136</u>

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

	ROAD FUND			
	Budgeted Amounts		Actual	Variance with
	Original	Final	Amounts, (Budgetary Basis)	Final Budget Positive (Negative)
REVENUES				
Intergovernmental Revenue	\$ 1,066,030	\$ 1,682,741	\$ 1,681,160	\$ (1,581)
Miscellaneous	1,000	91,185	88,355	(2,830)
Interest	2,500	4,211	4,573	362
Total Revenues	<u>1,069,530</u>	<u>1,778,137</u>	<u>1,774,088</u>	<u>(4,049)</u>
EXPENDITURES				
Roads	930,131	1,839,062	1,751,930	87,132
Debt Service:				
Principal	35,451	35,451	35,451	
Interest	11,974	103,774	11,551	92,223
Administration	207,219	213,026	185,720	27,306
Total Expenditures	<u>1,184,775</u>	<u>2,191,313</u>	<u>1,984,652</u>	<u>206,661</u>
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>(115,245)</u>	<u>(413,176)</u>	<u>(210,564)</u>	<u>202,612</u>
OTHER FINANCING SOURCES (USES)				
Transfers From Other Funds	100,000	450,000	200,000	(250,000)
Transfers To Other Funds	<u>(212,650)</u>	<u>(212,650)</u>	<u>(112,650)</u>	<u>100,000</u>
Total Other Financing Sources (Uses)	<u>(112,650)</u>	<u>237,350</u>	<u>87,350</u>	<u>(150,000)</u>
Net Changes in Fund Balance	(227,895)	(175,826)	(123,214)	52,612
Fund Balance - Beginning (Restated)	<u>227,895</u>	<u>275,826</u>	<u>276,067</u>	<u>241</u>
Fund Balance - Ending	<u>\$ 0</u>	<u>\$ 100,000</u>	<u>\$ 152,853</u>	<u>\$ 52,853</u>

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

LOCAL GOVERNMENT ECONOMIC ASSISTANCE FUND

	Budgeted Amounts		Actual Amounts, (Budgetary Basis)	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES				
Intergovernmental Revenue	\$ 278,000	\$ 603,134	\$ 603,134	\$
Miscellaneous	500	78,416	78,416	
Interest	2,500	2,500	2,398	(102)
Total Revenues	281,000	684,050	683,948	(102)
EXPENDITURES				
General Government	43,325	52,427	50,035	2,392
General Health and Sanitation	30,000	59,576	57,233	2,343
Recreation and Culture	8,000	11,469	8,105	3,364
Roads	56,000	180,071	88,719	91,352
Debt Service:				
Principal	2,828	2,828	2,592	236
Interest	3,172	3,172	2,908	264
Administration	37,250	278,940	30,933	248,007
Total Expenditures	\$ 180,575	\$ 588,483	\$ 240,525	\$ 347,958
Excess (Deficiency) of Revenues Over Expenditures Before Transfers and Financing Sources (Uses)	100,425	95,567	443,423	347,856
OTHER FINANCING SOURCES (USES)				
Transfers To Other Funds	(200,425)	(450,425)	(402,000)	48,425
Total Other Financing Sources (Uses)	\$ (200,425)	\$ (450,425)	\$ (402,000)	\$ 48,425
Net Changes in Fund Balances	(100,000)	(354,858)	41,423	396,281
Fund Balances - Beginning	100,000	104,858	104,898	40
Fund Balances - Ending	\$ 0	\$ (250,000)	\$ 146,321	\$ 396,321

BREATHITT COUNTY
BUDGETARY COMPARISON SCHEDULES
Required Supplementary Information - Modified Cash Basis
For The Year Ended June 30, 2006
(Continued)

COMMUNITY DEVELOPMENT BLOCK GRANT FUND			
	Budgeted Amounts		Variance with
	Original	Final	Actual Amounts, (Budgetary Basis) Final Budget Positive (Negative)
REVENUES			
Intergovernmental Revenue	\$ 1,000,000	\$ 1,000,000	\$ 516,585 \$ (483,415)
Total Revenues	1,000,000	1,000,000	516,585 (483,415)
EXPENDITURES			
General Health and Sanitation	1,000,000	1,000,000	516,585 483,415
Total Expenditures	1,000,000	1,000,000	516,585 483,415
Excess (Deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)			
OTHER FINANCING SOURCES (USES)			
Transfers From Other Funds			
Total Other Financing Sources (Uses)			
Net Changes in Fund Balances			
Fund Balances - Beginning			
Fund Balances - Ending	\$ 0	\$ 0	\$ 0 \$ 0

BREATHITT COUNTY
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

June 30, 2006

Note 1. Budgetary Information

Annual budgets are adopted on a cash basis of accounting and according to the laws of Kentucky as required by the State Local Finance Officer.

The County Judge/Executive is required to submit estimated receipts and proposed expenditures to the fiscal court by May 1 of each year. The budget is prepared by fund, function, and activity and is required to be adopted by the fiscal court by July 1.

The fiscal court may change the original budget by transferring appropriations at the activity level; however, the fiscal court may not increase the total budget without approval by the State Local Finance Officer. Expenditures may not exceed budgeted appropriations at the activity level.

Note 2. Reconciliation of Road Fund

Reconciliation of Road Fund

Total Expenditures - Budgetary Basis	\$ 1,984,652
Plus: Capital Lease Expenditures	<u>175,994</u>
Total Expenditures - Modified Cash Basis	<u><u>\$ 2,160,646</u></u>
Total Other Financing Sources (Uses) - Budgetary Basis	\$ 87,350
Plus: Capital Lease Proceeds	<u>175,994</u>
Total Other Financing Sources (Uses) - Modified Cash Basis	<u><u>\$ 263,344</u></u>

BREATHITT COUNTY
COMBINING BALANCE SHEET -
NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information

June 30, 2006

BREATHITT COUNTY
COMBINING BALANCE SHEET -
NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information

June 30, 2006

	Jail Fund	Disaster and Emergency Service Fund	Solid Waste Fund	E-911 Fund	Local Government Economic Development Fund
ASSETS					
Cash and Cash Equivalents	\$ 14,327	\$ 40,671	\$ 142,695	110,279	\$ 12,033
Total Assets	<u>14,327</u>	<u>40,671</u>	<u>142,695</u>	<u>110,279</u>	<u>12,033</u>
FUND BALANCES					
Fund Balances:					
Reserved for:					
Encumbrances	\$	\$ 19,811	\$ 9,951	\$	\$ 214
Unreserved:					
Special Revenue Funds	<u>14,327</u>	<u>20,860</u>	<u>132,744</u>	<u>110,279</u>	<u>11,819</u>
Total Fund Balances	<u>\$ 14,327</u>	<u>\$ 40,671</u>	<u>\$ 142,695</u>	<u>\$ 110,279</u>	<u>\$ 12,033</u>

BREATHITT COUNTY
COMBINING BALANCE SHEET -
NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information
June 30, 2006
(Continued)

Economic Assistance Fund	Total Non-Major Governmental Funds
<u>\$ 386,303</u>	<u>\$ 706,308</u>
<u>386,303</u>	<u>706,308</u>

\$	\$ 29,976
<u>386,303</u>	<u>676,332</u>
<u>\$ 386,303</u>	<u>\$ 706,308</u>

BREATHITT COUNTY
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information
For The Year Ended June 30, 2006

BREATHITT COUNTY
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information

For The Year Ended June 30, 2006

	Jail Fund	Disaster and Emergency Service Fund	Solid Waste Fund	E-911 Fund	Local Government Economic Development Fund
REVENUES					
Taxes	\$	\$		\$ 101,653	\$
Intergovernmental	124,228	65,422	45,109		251,000
Charge for Services	3,769		80,033		
Miscellaneous	2,053		10,011	1,100	
Interest	324		1,168	1,076	
Total Revenues	<u>130,374</u>	<u>65,422</u>	<u>136,321</u>	<u>103,829</u>	<u>251,000</u>
EXPENDITURES					
General Government					200,482
Protection to Persons and Property	450,777	109,330		90,617	
Health and Sanitation			86,294		
Recreation and Culture					41,000
Debt Service:					
Interest	765				
Administration	24,620		17,331	10,457	
Total Expenditures	<u>476,162</u>	<u>109,330</u>	<u>103,625</u>	<u>101,074</u>	<u>241,482</u>
Excess (deficiency) of Revenues Over Expenditures Before Other Financing Sources (Uses)	<u>(345,788)</u>	<u>(43,908)</u>	<u>32,696</u>	<u>2,755</u>	<u>9,518</u>
Other Financing Sources (Uses)					
Capital Lease Proceeds	21,015				
Transfers From Other Funds	342,000				
Transfers To Other Funds	(27,999)				
Total Other Financing Sources (Uses)	<u>335,016</u>				
Net Change in Fund Balances	(10,772)	(43,908)	32,696	2,755	9,518
Fund Balances - Beginning	25,099	84,579	109,999	107,524	2,515
Fund Balances - Ending	<u>\$ 14,327</u>	<u>\$ 40,671</u>	<u>\$ 142,695</u>	<u>\$ 110,279</u>	<u>\$ 12,033</u>

BREATHITT COUNTY
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - NON-MAJOR GOVERNMENTAL FUNDS - MODIFIED CASH BASIS
Other Supplementary Information
For The Year Ended June 30, 2006
(Continued)

Economic Assistance Fund	Total Non-Major Governmental Funds
	\$ 101,653
150,000	635,759
	83,802
	13,164
	2,568
<u>150,000</u>	<u>836,946</u>
13,697	214,179
	650,724
	86,294
	41,000
	765
	52,408
<u>13,697</u>	<u>1,045,370</u>
<u>136,303</u>	<u>(208,424)</u>
250,000	21,015
	592,000
	(27,999)
<u>250,000</u>	<u>585,016</u>
386,303	376,592
	329,716
<u>\$ 386,303</u>	<u>\$ 706,308</u>

BREATHITT COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For The Year Ended 2006

**BREATHITT COUNTY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

Fiscal Year Ended June 30, 2006

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the governmental activities, each major fund, and aggregate remaining fund information of Breathitt County, Kentucky.
2. No reportable conditions relating to the internal control of the audit of the financial statements are reported in the Independent Auditor's Report.
3. No instances of noncompliance material to the financial statements of Breathitt County were disclosed during the audit.
4. No reportable conditions relating to the audit of the major federal awards programs are reported in the Independent Auditor's Report.
5. The auditor's report on compliance for the audit of the major federal awards programs for Breathitt County expresses an unqualified opinion.
6. There are no audit findings relative to the major federal awards programs for Breathitt County reported in this schedule.
7. The programs tested as major programs were: Community Development Block Grant (14.228) and State Homeland Security Grant Program (97.004)
8. The threshold for distinguishing Type A and B programs was \$300,000.
9. Breathitt County was not determined to be a low-risk auditee.

B. FINDINGS – FINANCIAL STATEMENT AUDIT

None

**C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARDS PROGRAM
AUDIT**

None

D. SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

None

BREATHITT COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

BREATHITT COUNTY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Fiscal Year Ended June 30, 2006

<u>Program Title</u>	<u>Pass-Through Grantor's Number</u>	<u>Federal CFDA No.</u>	<u>Expenditures</u>	<u>Total By CFDA #</u>	
U. S. Department of Commerce					
<i>Administered through NOAA</i>					
Congressionally Identified Awards and Projects					
PRIDE Grant (Dump Cleanup)	SG05-01	11.469	\$ 16,900		
PRIDE Grant (Dump Cleanup)	CF05-05	11.469	30,159		
Total U.S. Dept of Commerce				47,059	
U.S Department of Housing & Urban Development					
Community Development Block Grants/State Programs					
<i>Passed Through from Kentucky Dept of Local Government</i>					
<i>Passed Through to Breathitt Co Water District (Note B)</i>					
Community Development Block Grant	04-068	14.228	516,585	516,585	***
U.S. Department of Homeland Security					
<i>Passed Through KY Dept of Homeland Security:</i>					
State Homeland Security Grant Program - WMD03	M-03254738	97.004	109,330	109,330	***
Emergency Management Performance Grant	M-05029993	97.042	13,205	13,205	
<i>Passed Through KY Dept of Military Affairs:</i>					
Public Assistance Grant	FEMA-1523-DR-KY	97.036	29,159	29,159	
Total U.S. Dept of Homeland Security				151,694	
TOTAL EXPENDITURES OF FEDERAL AWARDS				<u>\$ 715,338</u>	

*Tested as major program or cluster ****

BREATHITT COUNTY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2006

Note 1 – Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Breathitt County, Kentucky and is presented on a modified cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations.

Note 2 – Subrecipients

The Breathitt County Fiscal Court provided Federal awards to subrecipients as follows:

Breathitt County Water District

	<u>CFDA #</u>	<u>Amount</u>
Community Development Block Grant (KY 53/541 Waterline Project)	14.228	\$ 516,585

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

ROSS & COMPANY, PLLC
Certified Public Accountants
800 Envoy Circle
Louisville, KY
Telephone (502) 499-9088
Facsimile (502) 499-9132
www.rosscpas.com

The Honorable Jason Harvey Richardson, Breathitt County Judge/Executive
The Honorable Lewis Warrix, former Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Report And On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Breathitt County, Kentucky, as of and for the year ended June 30, 2006, which collectively comprise the County's basic financial statements, as listed in the table of contents and have issued our report thereon dated January 10, 2007. Breathitt County prepares its financial statements in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Breathitt County's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statement being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether Breathitt County's financial statements as of June 30, 2006, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of material noncompliance or other matters that are required to be reported under Government Auditing Standards.

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of Financial
Statements Performed In Accordance With Government Auditing Standards
(Continued)

This report is intended solely for the information and use of management and the Governor's Office for Local Development and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

A handwritten signature in cursive script that reads "Ross & Company". The signature is written in black ink and is positioned above the printed name of the firm.

Ross & Company, PLLC

Audit fieldwork completed -
January 10, 2007

**REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

ROSS & COMPANY, PLLC
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www.rosscpas.com

The Honorable Jason Harvey Richardson, Breathitt County Judge/Executive
The Honorable Lewis Warrix, former Breathitt County Judge/Executive
Members of the Breathitt County Fiscal Court

Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133

Compliance

We have audited the compliance of Breathitt County, Kentucky, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2006. Breathitt County's major federal programs are identified in the summary of auditor results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Breathitt County's management. Our responsibility is to express an opinion on Breathitt County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Breathitt County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Breathitt County's compliance with those requirements.

In our opinion, Breathitt County complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2006.

Internal Control Over Compliance

The management of Breathitt County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Breathitt County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

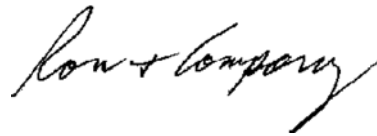
Report On Compliance With Requirements
Applicable To Each Major Program And On Internal Control
Over Compliance In Accordance With OMB Circular A-133
(Continued)

Internal Control Over Compliance (Continued)

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than the specified parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ross & Company", written in a cursive style.

Ross & Company, PLLC

Audit fieldwork completed -
January 10, 2007

**CERTIFICATION OF COMPLIANCE -
LOCAL GOVERNMENT ECONOMIC ASSISTANCE PROGRAM**

BREATHITT COUNTY FISCAL COURT

**For The Fiscal Year Ended
June 30, 2006**

